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In the Supreme Court of the United States

No. 74-1518

THE TELEX CORPORATION and TELEX COMPUTER PRODUCTS, INC.
Petitioners,

vs.

INTERNATIONAL BUSINESS MACHINES CORPORATION,
Respondent.

Reply Brief in Support of Petition for Writ of Certiorari

Despite an unremitting effort to divert attention from the basic issues, the core of IBM's opposition is a confession that the case calls for review by this Court. The purpose of this reply brief is to lay the core bare.

As part of its diversionary tactics, IBM assails the amount of damages awarded Telex by the trial court. But the Court of Appeals never considered that question. Once it be held that the trial court's unassailed findings correctly convict IBM of violation of Section 2 of the Sherman Act, the issue of amount of damages will become available to IBM. So, also, from the beginning and throughout, IBM's brief would deflect attention from its own conduct by charging Telex with misappropriation of trade secrets. IBM evidently hopes to insinuate a notion that one who is held to have misappropriated trade secrets is to be denied the protec-

All emphasis in quotations in this brief is added unless otherwise noted.

tion of the Sherman Act! That turns the law upside down. Protection of the law is denied to the patentee who violates the antitrust law, not to the infringer, and Question IV of the petition (Pet. 4, 5) submits that the same principle applies to trade secret rights. And if IBM is not barred by its antitrust violation, it will have had the fullest relief for the claimed misappropriation.[1]

None of the diversionary arguments is pertinent to the important questions under Section 2 of the Sherman Act presented by the petition. IBM does not deny the importance of those questions. It seeks only to elude them by ignoring what the Court of Appeals decided and by offering something different as the case. Thus, at the outset (Br. 3), it asserts that the "result reached by the Court of Appeals is * * * sustainable on * * * independent grounds, not reached below." But if there are "independent grounds", they can be considered only when the law is purged of the errors of the opinion below.

Telex rests on the trial court's findings, which were wholly untouched by the Court of Appeals, and therefore control, both under the "two-court" rule and the "clearly erroneous" principle (F.R. Civ.P. Rule 52(a)). IBM, on the other hand, tenders to this Court versions of the facts which the trial court rejected, which IBM then pressed on the court below as a basis for reversal, and which that court did not accept.

IBM continually seeks to restructure the case as one where the question is whether it acquired its position of dominance and power legitimately. Since the petition does not criticize the manner in which IBM acquired the position it occupied immediately before it embarked on the conduct condemned by the trial court, we need not reply to IBM's self-praise. The issue decided by both

1. The trial court penalized Telex in duplicate. (1) It gave IBM its counterclaim judgment and (2) reduced, before trebling, the antitrust damages suffered by Telex by the amount Telex would have supposedly gained from the use of the trade secrets (App. 170).

courts below has to do with the kind of conduct permissible to the end of *maintaining* that position.

Again, throughout IBM's brief there is studied effort to suggest, both openly and covertly, that the relevant market is the whole and every adjunct of electronic data processing — CPU's, peripherals, general systems, software, leasing, consulting organizations, and service businesses. Only in this way can IBM shrink its share of the market to the percentages which its brief assigns to itself. As an example, IBM cites Finding 61 (App. 39) that IBM's share of electronic computers and peripheral equipment was only 36.7%. But what that Finding said was that, *if* the market were "so broadly defined" as to be the "EDP industry as a whole or the general system (CPU) market", plaintiffs had not carried the burden of showing monopoly power. But that capacious notion of the market was rejected by both courts below.[2]

In the same way, IBM repeatedly transforms facts and findings by selecting phrases out of context. In order to stay within

2. Similarly, IBM states that the number of competitors in the EDP industry had grown from 13 in 1952 to over 1,700 in 1970, and the number of makers of computer *systems* from 3 to 96, citing F. 59 (App. 37). But that finding starts off, "Defining the market broadly, as IBM claims it should be." And both courts rejected this claim of IBM. While this case is set in the EDP "industry," it concerns peripherals. The same finding concludes by making the contrast which IBM would ignore: "There is little or no indication in the evidence introduced in this case that IBM adopted specific programs to throttle or impede general systems competition or that it sought to implement any predatory intent with respect to the EDP industry as a whole, *as distinguished from efforts directed specifically against the marketers of peripheral equipment plug compatible to its CPU's.*"

IBM's claim about broad EDP "market" or a broad systems market is as meaningless as enlarging the competitors in the automobile industry by counting the makers, not only of automobiles, but of batteries, bodies, tires, spark plugs, mufflers, engines, carburetors, sheet metal, paint, plus distributors, dealers, repair mechanics, and so on.

Even as to a general systems market, IBM had 65% of all installed CPU's and the 3 next largest each had less than 13% of IBM's EDP revenue (Pet. 9). General Electric went out of the business in 1970 and RCA in 1971 (Pet. 15), and in July 1975, since the petition was filed, Zerox announced its withdrawal.

the permissible limits of a reply brief in support of a petition for certiorari, we shall refer only to some of these transformations, and then only in the context of exposing the core of IBM's opposition.

A. Maintenance of Monopoly Position and Power by Affirmative Conduct (Questions I and II of the Petition).

IBM's case under this heading comes to the claim, expressed in many variations, that all it did was to introduce a couple of new products at "reasonable prices" or prices resulting in "reasonable profit margin" or producing only a "reasonable profit", that it made " 'reasonable' price reductions" not below its costs. (E.g., Br. 4, 18, 19, 20, 24, 26, 30, 38).

1. This is the version which the trial court rejected as "bland" (Pet. 16). *If* it were true, it would simply highlight the importance of review by this Court. Courts have no competence to determine "reasonableness" of prices under Section 1. Are they to be sucked into the quagmire of doing so under Section 2?

In the *Alcoa* case (*United States v. Aluminum Co. of America*, 148 F.2d 416, 2 Cir. 1946), Judge Hand dismissed arguments about the correctness of a trial court finding that Alcoa's profits for over a half century had been only 10%, by saying (p. 427):

> "But the whole issue is irrelevant anyway, for it is no excuse for 'monopolizing' a market that the monopoly has not been used to extract from the consumer more than a 'fair' profit."

In *United States v. Cohen Grocery Co.*, 255 U.S. 81 (1921), a statute making it unlawful to "make any 'unreasonable' rate or charge in handling or dealing in or with any necessaries" or to "exact excessive prices" was held unconstitutional for failure to state an "ascertainable standard of guilt." In *Cline v. Frink Dairy Co.*, 274 U.S. 445 (1927), a state antitrust law prohibiting conspiracies to increase or reduce prices unless the object and purpose was to "conduct operations at a reasonable profit" or to

"market at a reasonable profit" was held void for the same reason, and the Court said that it "would tax human ingenuity" to make such a determination (p. 458). Yet this is the standard the court below set, and IBM defends, as the turnstile by which courts are to separate innocence from guilt under Section 2 of the Sherman Act! If the question does not answer itself, certainly it presents an issue of the utmost importance for settlement by this Court.

There is no magic in "sale below cost" as an essential to unlawful conduct under Section 2. Sale below cost is powerful proof of an intent to exclude competition and to exercise monopoly power, but that intention can exist and be established without sales being below cost. Indeed, only the naive can believe that there is any way to determine costs of a particular product of a large manufacturer of many products where numerous cost allocations must be made and can be manipulated.

2. Moreover, IBM's statement that the case involves only the introduction of new products at a reasonable price, and the like, is not so. It ignores a whole series of facts (Pet. 22, 34, 37-39; App. 150-1). For example:

(a) Its brief is notably silent about IBM's *intent*, which was to destroy its competition; IBM aimed at its peripheral competitors, fired, and hit.

(b) Only a passing reference can be found in IBM's brief to the fact that while cutting prices and putting into effect its long-term leasing plan with respect to peripherals, it concurrently raised its rates on CPU's and did not tie them up on long-term leases. It raised prices in a protected market in order to cut prices and drive out competition in a competitive market. This is the issue presented in petition's Question II, and on it IBM's brief remains mute. In short, it ignores the fact that the "price reductions" were not reductions at all but a manipulation involving a "wash" for

IBM, for its systems competitors, and for its computer customers who also used IBM peripherals and avoided those of peripheral competitors. For the peripheral competitors it was destruction.[3]

(c) It ignores IBM's long-term lease plan designed to cut off cash-flow of competitors so as to prevent them from producing "follow-on" products. The petition (p. 11) cited an IBM memorandum (P. Ex. 141A) that the result of the plans IBM devised would be, for any peripheral competitor, a "dying company!" IBM responds by quoting from the same memorandum a statement that a company producing "follow-on" products would be growing and profitable (Br. 29). But the very thrust of IBM's long-term lease plan and price cuts was to disable peripheral competitors from being able to develop "follow-on products". The petition (p. 14), referring to this very exhibit, said that "An IBM analysis showed that these term leases would lock-out the plug compatible competitors from the market for 24 months, turn their profits into losses and defer profits so long that the competitors could not develop follow-on products and would die."[4]

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3. As if it were germane to the point under discussion, IBM asserts that it had CPU competition (Br. 39). While there were some other makers of CPU's (all relatively small) who might be considered competition for original installation, IBM was immune on installations already out on lease, for all the reasons detailed at Pet. 15, 16, which IBM does not even try to answer. And even on new installations, the stability reached between IBM and other makers of CPUs was not disturbed by IBM's increase of its CPU prices for that was offset by the decrease in its peripheral prices.

4. IBM denies that it grossly undercut Telex's prices (e.g., at Br. 27) and humorlessly cites F. 95a (App. 61) that between 1968 and 1972 Telex priced its products at lower prices than IBM except on four occasions. The four occasions are the very conduct which produced this lawsuit. Telex had to price lower than IBM in order to sell (Pet. 13). When IBM undercut, Telex had to plummet to prices disastrous to it,

(d) IBM ignores the fact that the 2319A and 2319B disk drives "introduced" by IBM were not new at all but were a mere camouflage of old models for the purpose of avoiding general price reduction on items already leased (Pet. 11).

(e) It erroneously characterizes the finding about profits and reasonableness of price cuts and prices. The findings speak of "price cuts upon price cuts", "substantial" in size, deliberately made to undercut competitors' costs (App. 150, 151). There is no evidence and no findings that IBM's prices or profits were "reasonable". The finding IBM cites (F. 111a, App. 74) is quite different; it is no more than that IBM anticipated that it would make a profit of at least 20% at its reduced prices and with its long-term leasing plan, but that "those profit margins in part would be achieved by obtaining leases of products which would otherwise have been made by Telex and other PCM's", i.e., achieved by the success of excluding competitors. And, until that was achieved, and for the first two years, IBM's prices would impose on it a *loss* of $75.6 million (Pet. 14).

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which is exactly what IBM planned and designed. IBM's disk drive price was cut so far below Telex's that in order to keep its disk drives rented Telex had to lose $1,700 per device on each machine installed (see P. Ex. 671, p. 2; testimony, DJ 737, 738, 759-72; Tr. 90). As noted at Pet. 12, Telex remained viable after the disk price cut only because it was also marketing tape drives and a printer (P. Ex. 162), to which IBM's price cut did not apply, whereupon IBM came out with its Fixed Term Plan, striking Telex on its whole product line. Within 6 months of the Fixed Term Plan Telex's monthly sales rate on tape drives was down to 62% (F. 105, App. 69). And, as found in F. 108 (App. 71), IBM set the monthly rental of FET monolithic memory at a price "less than the amount reporting experts had indicated a potential competitor would be required to charge in order to enter the market and be profitable and viable." Furthermore, IBM's conduct, by making it impossible for Telex to market at a profit, choked off new financing (Pet. 18).

B. The Issue of Attempt to Monopolize (Question III(e) of the Petition).

IBM's treatment of this issue (Br. 42) is to argue that conduct not "unlawfully exclusionary" for purposes of monopolizing cannot be the basis of an "attempt to monopolize." But our discussion of "attempt to monopolize" was not addressed to the holding of the Court of Appeals about what conduct is legitimate to a monopolist. It was addressed to the court's reasoning about "relevant market"; if that reasoning could serve to exculpate IBM of monopolization, it plunged IBM into conviction of an attempt to monopolize, relegating its defense to the contention that its conduct was legitimate whatever the relevant market (Pet. 39).

The rest of IBM's argument on the subject is an effort to obscure. Thus (Br. 42) Telex' argument is characterized as saying that the "courts below also necessarily found (*although they did not appreciate the fact*) that there existed a dangerous probability of IBM's monopolization of a broader asserted 'market' ", that the "courts below have necessarily, although *unconsciously,* held IBM guilty of attempted monopolization", and that the district court necessarily found that "IBM had *something called 'specific intent'* ". But the district court was neither unconscious nor unappreciative. It explicitly held that there was a "dangerous probability" of monopolization, and that IBM had the "specific intent" to monopolize a market consisting of the very market the Court of Appeals held to be the relevant one, that is, a market of peripherals whether plug compatible with IBM's CPUs or not, and it held that IBM was guilty of an attempt to do so. (Findings quoted, Pet. 21-22). The Court of Appeals disputed none of those findings. And IBM's dismissal of "specific intent" as a "something" evidences its avoidance of the law, for "specific intent" is the precise term given by Mr. Justice Holmes in *Swift & Co. v. United States,* 196 U.S. 375, 396 (1905) to a basic concept of the offense of attempt to monopolize and ever since secure in the law.

C. Relevant Market (Question III of the Petition).

The issue here is whether, on a correct legal standard applied to the facts found by the trial court, the market consists of peripherals plug compatible with IBM CPU's, as the trial court held, or includes peripherals not so compatible. IBM does not deny that 65% of all installed computers are IBM's. It does not deny that a user of an IBM CPU cannot use a non-compatible peripheral. The basic reasoning of the court below was that a manufacturer of peripherals plug compatible with IBM CPU's can with small expense turn to making peripherals usable on other CPU's. Question III presented by the petition proceeds on the assumption that this is true,[5] submitting that "any definition which ignores the buyers and focuses on what the sellers do, or theoretically can do, is not meaningful."[6] Yet that is what the Court of Appeals here did. And, in the end, IBM seeks to support the decision below essentially on two grounds both different from that of the Court of Appeals.

1. Its principal argument, pervading its entire discussion (Br. 45-57), starts with the statement that a market defined as periph-

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5. In fact it is not so, and it also ignores that cost of interfacing is only an element in the important factor, which is whether an economic reward can be obtained. Thus Finding 38 (App. 23) found:

> "* * * suppliers of peripherals plug compatible with non-IBM systems could in various instances shift to the production of IBM plug compatible peripherals, and vice-versa, *should the economic rewards in the realities of the market become sufficiently attractive and if the predatory practices of others did not dissuade them.*"

Producing peripherals plug compatible with non-IBM CPU's offered no prospect of reward because of tinyness of the market offered by any of these other CPUs.

6. The quotation is from *United States v. Bethlehem Steel Co.,* 168 F.Supp. 576, 592 (S.D.N.Y. 1958, Weinfeld, J.) which is often quoted or closely paraphrased, as in *George R. Whitten, Inc. v. Paddock Pool Builders, Inc.,* 508 F.2d 547, 551 (1 Cir. Dec. 1974):

> "A market definition which is confined to the seller's perspective is not meaningful [citations omitted]. By necessity, definition of 'market' must also focus on attitudes and reactions of consumers."

erals plug compatible with IBM CPUs is one "defined in terms of equipment designed by IBM and thereafter copied by others"[7] (Br. 45). It is then argued (Br. 46) that the logic of this definition "leads inescapably to the conclusion that every EDP systems supplier has monopoly power" over the peripherals compatible with its system because, "as each new system is introduced, the supplier supplies 100% of the demand for the peripherals supplied with the system." The conclusion IBM would then draw is that, unless the Court of Appeals is sustained, every such supplier becomes a violator of Section 2. This reasoning is full of gaps. First, such a monopoly power over the peripherals of the hypothetical EDP systems supplier could be one lawfully acquired. But the issue in this case is something else—whether a power lawfully acquired was exercised to *maintain* itself. Second, even maintaining the "monopoly" power over the peripherals for a particular make of CPUs would not violate Section 2 if the market were not a "relevant" one. It could be or it could not be "relevant". It would not be if the demand for those peripherals is slight, as when the manufacturer of the particular CPUs has so slight a share of the CPU market that there is no economic attraction for other manufacturers of peripherals to seek to tap it. A market is relevant in law if it is relevant in the realities of the market place, that is, when in fact people begin to compete. If it is, the exercise of monopoly power in that market to exclude competition should not be tolerated. All this the trial court said in F. 37 (App. 21) and Conclusion 13 (App. 139).

In the third place, an unstated premise of IBM's argument implies that there is something discreditable about "copying".

7. IBM's statements that Telex copied IBM's peripherals is not true. What Telex duplicated was the "interfaces" between CPUs and peripherals, and interfaces have to be identical in order for the peripherals to be plug compatible with IBM CPUs. Apart from the interfaces, Telex' peripherals, while performing the same function as well or better, were different.

In the report of June, 1970, of IBM's "Peripherals Task Force" (described at Pet. 11), it stated under the caption "Why We Have The Problem", that "Any Successful Product Will Attract Entrepreneurs" and "Any Product Can Be Copied in Time" (P. Ex. 40, E. 55).Yet, now, IBM in effect submits as the law that a company whose product is copied should be free to destroy the copiers. But the antitrust laws encourage copying of a non-patented item. More apt to the facts of this case, IBM's unstated premise is that the maker of a product has a moral right to monopolize accessories to it. The law does not place a fence around a new market to protect John Doe because the market had come into being by his efforts alone instead of by the efforts of many. American industry is full of situations involving a *host* industry and *accessory* suppliers. Creation by the host of the market for the accessories does not permit the host to monopolize the accessories. Were General Motors to produce an automobile using a new type of unpatented ignition or carbutetor—say, an electronic one—and if it were the first to produce the ignition or carburetor to fit the automobile, it could not monopolize that accessory because it created the need and had 100% of the market at the start. That conduct the trial court held that the law does not permit. It is not this decision that was a "novel and dangerous misuse of the Sherman Act", as IBM asserts (Br. 54), but the decision of the Court of Appeals reversing the trial court.

2. IBM seeks to support the decision of the court below as to relevant market on still another ground. It asserts (Br. 46) that its "peripherals in fact compete with the peripherals of systems suppliers, peripheral suppliers, and leasing companies." Of course IBM's peripherals were competing with peripheral suppliers of IBM plug compatible peripherals; that is what this case is about. So far as leasing companies buy and lease IBM peripherals, the peripherals are IBM peripherals. As to "peripherals of systems suppliers", the trial court found (F. 53, App. 33) that "the relationship of this competition to the relevant markets with which

we are concerned again is tangential and practically *indiscernible.*" Finding 38, which IBM cites (Br. 16, 46), for its assertion was only that, to a prospective consumer for a CPU, the peripherals that could be used with it could be a factor bearing on whether to acquire a CPU of IBM or of another, and for that reason "indirectly" and "to some degree" the peripheral products attached to non-IBM systems constrain IBM's power with respect to peripherals attached to the IBM system (F. 38, App. 22). But thrown into the scales with all the realities of the market, of competitive conduct, recognition by IBM itself, historic economic fact, and not mere theory, the trial court found that peripherals plug compatible with IBM CPUs are a separate market. Moreover, after the prospective customer acquires an IBM computer, it becomes a captive market for peripherals plug compatible with that computer.

3. IBM (at B. 14) assails a supposed statement of the petition that at the time of trial there were only 12 companies making peripherals for use with IBM equipment. The statement of the petition (p. 9) was that "there were 11 *such* in addition to Telex." The "such" refers back to the earlier statements on the same page which begin with the sentence "Peripherals like those with which this case is concerned", immediately identified as "tape drives, disk drives, printers, memories, and communication controllers", each having a "unique function."[8] IBM's denial is based on F. 63

8. In Conclusion 14 (App. 140) the trial court stated:
"Each of these types of plug compatible products performs a basically unique and distinct function when utilized with an IBM CPU * * *. It would be neither realistic nor consistent with the policy of the antitrust laws to ignore the severance and separability of these fields of competition or in more broadly defined markets to leave the dominant power free to sharpshoot at essentially separate and distinct components and to eliminate them one by one * * *."

For IBM to include makers of peripherals performing completely different functions is like lumping in makers of windshield wipers or light bulbs in a tire or batteries case.

(App. 40) that the number of companies making peripherals grew from two or three in 1966 to over 100 at time of trial. But those making the kinds of peripherals with which this case is concerned were never more than 12. IBM even expands its assertion to a claim (Br. 32) that the "district court found that IBM was engaged in competition with at least 100 companies supplying peripheral equipment for use with IBM equipment." Finding 63 says nothing to that effect; the sentence giving the numbers of peripheral manufacturers is followed by this:

> "A number of these handled only one type of device and few if any had the variety of peripheral devices plug compatible to IBM CPUs that Telex had. The relatively large number of companies in time engaged in the plug compatible business did not represent a corresponding dispersal of the business, since the major share during the developing years was concentrated within a matter of a *dozen* plug compatible manufacturers (PCM)."

The Court of Appeals agreed that "Telex and some eleven others were the major manufacturers of IBM plug compatible products." (App. 198.)

IBM also serenely heaps together unlike things when it asserts (as at Br. 14, 49) that other "systems" manufacturers and peripheral producers make peripherals for use with non-IBM CPUs. The broad term, "peripherals", may cover devices (like a teletypewriter at the end of a telephone line) that operate with any CPU without plug-compatible interface, but they do not fall in the "plug compatible" category and this case does not concern them. IBM's brief avoids saying that makers of plug-compatible peripherals supplied any to consumers which they could plug into a non-IBM computer. The fact shown by the record is the quite different one that some makers have supplied peripherals to CPU manufacturers which the latter integrate into their system, ordinarily after devising and making their own interfaces. Even

there, while Telex has explored possibilities of that business,[9] it has done no such business except for small sale to a group of former RCA personnel who supplied the RCA interface to serve RCA computers after RCA abandoned the computer business. Finding 45 states the final truth (App. 28), "during the period with which we are concerned supply substitutability was a minimal factor in the marketplace as a constraint upon pricing."

D. Antitrust Violation as Bar to Protection of Trade Secrets (Question IV of the Petition).

As part of its diversionary effort, IBM asserts that the petition does not deny misappropriation of trade secrets (Br. 20, 57). But this testifies only to Telex's conscientiousness in not discussing in a petition for certiorari a pure issue of fact relevant only to a pure question of Oklahoma state law, wholly alien to the important antitrust issues of paramount federal law.[10]

There *is* a trade secret issue important to antitrust law. It is whether one who is adjudged guilty of violating Section 2 of the Sherman Act should be entitled to aid of the courts to protect trade secrets. IBM would elude that question by relying on something not decided below. It argues that the misappropriated trade secrets are "wholly independent of the acts by which Telex claims IBM violated Section 2 of the Sherman Act" (Br. 58).[11]

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9. The exhibits cited in IBM's Br. 11 as showing that Telex had "marketed" to 16 other suppliers of computer systems shows nothing but exploration.

10. The trade secret issue did not lie in copying, for copying could be effected by mere examination and dissection of the IBM interfaces. The trade secret issue had to do with whether Telex gained "lead time" before the physical object became available to inspect (Conclusion 45, App. 176).

11. In the trial court, IBM successfully argued that its counterclaim was "connected with the subject of the action" (App. 179, Conclusion 51), and its brief elsewhere asserts (as at p. 20) that Telex "stole the very products to which it claimed injury in its business or property by reason of IBM's alleged monopolization." All this confesses that the trade secrets and the antitrust violation are not independent.

The argument is premature and presumptuous, for the court below simply declined to face the question at all, because it decided that there was no violation of Section 2 (App. 257-8). If this Court holds that IBM did violate Section 2 but that a Sherman Act violation bars enforcement of trade secret rights only if the trade secrets are not independent of the acts constituting the violation, the case can be remanded for determination whether there was such independence here.

CONCLUSION

IBM and its relation to Telex are an object lesson. Beginning in 1958 and for about 10 years IBM marketed a tape drive (its 729) without reduction of price; assigning to the item a cost of $5,200 per unit, it charged a rental of $920 per month! Telex's entry into the plug compatible business occurred in 1966, when it designed a tape drive performing the same function and captured from IBM the replacement business of the duPont Company by charging a rental approximately two-thirds of IBM's (Pet. Ex. 40, E. 55; F. 12, App. 8). The other plug compatible competitors entered later. That was competition at work. With its plug compatible competition eliminated, IBM can return to its higher prices and its years of complacency.

IBM wishes Section 2 of the Sherman Act to be construed so as, in the words of *Mogul Steamship Company v. MacGregor,* 23 Q.B.Div. 598, [1892] A.C. 25, to make it lawful "ordinary course of trade so to compete for a time as to render trade unprofitable to your rival in order that when you have got rid of him you may appropriate the profits of the entire trade to yourself."

We respectfully submit that the petition should be granted.

Dated: September 17, 1975.

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